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Before the Committee on Post Office and Civil Service
U.S. House of Representatives
on
Civil Service Retirement System
March 26, 1984

Mister Chairman and Members of the Committee.

Thank you for the opportunity to testify on the Civil Service Retirement System.

The National Taxpayers Union represents 130,000 dues-paying members who are interested in reducing the burden of government on the American taxpayers. In studying the federal pension issue, we have tried to be as objective as possible in our analyses. However, we will warn you ahead of time that we have a definite slant in our perspective -- and that's from the point-of-view of the American taxpayer, the silent majority whose benefits are modest in comparison to the Civil Service Retirement system, who pay for 87% of the cost of the federal employee plan, and who believe they are not being fairly represented -- at least on this issue -- by the Senators and Congressmen they elected into office.

No doubt in the past few weeks you have heard many compelling arguments from federal employees concerning their pensions. But I doubt that you have heard anything about how the current CSRS is not good for the majority of federal employees or for the taxpayers at large.

As a good employer and a fiscally responsible organization, the federal government should first establish objectives and guidelines for use in developing its retirement programs.

Objective Number 1:

At National Taxpayers Union, we believe that federal employees deserve a fair and reasonable pension for their hard work and dedicated service. At the same time, we believe the federal government, as an employer, has an obligation to ensure at least a minimal level of financial security for all of its employees in retirement.

I would suggest that you and your predecessors, despite your success in creating what many consider to be one of the most generous pension programs ever created, have failed in meeting this most basic objective.

That is because 62% of all current actively working federal employees will leave government service before becoming eligible for Civil Service Retirement benefits. When this majority leaves government service, all they receive is a refund of their 7% contributions, without interest. It is a refund that I suspect many use to buy a new car or take a nice vacation ... but not put away to ensure their financial security in retirement. The bottom line is this ... the current system benefits a few at the expense of the majority.

Objective Number 2:

The federal employee groups and Congress have said repeatedly in recent years that the federal government, as the nation's largest employer, should set an example for other employers.

We agree, but once again, we suggest that Congress has failed.

First, any organization that does not ensure even minimal financial security in retirement for the majority of its employees is a bad example. Any system that benefits a few at the expense of everyone else is a bad system.

Second, a good example is one that is consistent in its dealings and does not favor one group over the others. By letting federal employees retire with full benefits at 55 while increasing the age for full Social Security benefits to 67 and offering even greater penalties for "early" retirement at 62, Congress is letting a double standard operate.

Third, a responsible organization ensures the financial integrity of its retirement programs. It follows the same rules required of other organizations and learns to operate within its own means. The Civil Service Retirement System does not have to meet the tough ERISA requirements imposed on private sector businesses. It is not limited by the amount of money held by a trust fund like Social Security. That's a double standard, and that's why the federal government is not living up to its longstanding objective of serving as an example for other employers.

Objective Number 3:

Objective number 3 relates to the Committee's question about our views on comparability analysis.

We believe that the norm of society should be the governing principle in setting federal pay and benefit levels. By this we mean:

Comparability on a total compensation basis ... with an honest comparison with the private sector.

For wages and salaries, the norm for comparison should be the average for all businesses in the private sector. We believe the data base used in the Hay Associates analysis is too narrow. It should include smaller businesses. We suggest that a sample of businesses, large and small, including state and local governments, and representing a broader array of jobs be used for comparability purposes. This kind of comparison would comply more correctly with the provisions of Section 5301, Title 5 of the U.S Code, which says: "Federal pay rates be comparable with private enterprise pay rates for the same levels of work." My reading of Section 5301 does not restrict the comparison to only the largest private sector corporations.

Secondly, for comparability, we recommend a retirement system for federal employees based on the norm for the private sector. This means mandatory Social Security for all current and future federal workers; a supplemental pension program fully paid by the government with an employer normal cost of no more than 8% of payroll; and a system that fully meets all ERISA guidelines.

Thirdly, the comparability analysis should consider a fair evaluation of other employee benefits. It should recognize that federal health benefits are not as comprehensive as private sector plans, while also indicating that federal vacation and sick leave policy is more liberal. Similarly, it should recognize that stock options, profit-sharing, bonuses, expense accounts, company cars, and free parking are the exceptions -- not the norm -- in the private sector.

Objective Number 4:

The government should encourage savings, investment, and greater self-sufficiency. To meet this objective, we recommend a voluntary optional thrift plan in which federal employees can contribute up to a certain percentage of their salaries -- say 6% -- and have the government match it 50 cents on every dollar they contribute, up to a maximum of 3%.

General Design Considerations

In focusing on these objectives, we've touched briefly on some general design considerations for a new Civil Service Retirement System. Let's look at this question in more detail.

For current federal employees hired before January 1, 1984, we recommend transferring everyone -- except those age 50 and over and with 20 plus years of service, or any age but with 25+ years of service -- into a new Social Security-based system. Credit the 7% contributions these employees have already made to the CSRS to Social Security. Since the CSRS's employee contribution rate has been higher than the Social Security rate, the added amount that federal employees have paid could be invested in a thrift plan, with a 50% match from the government.

For those over the age and service requirements, allow them to remain grandfathered in the present Civil Service Retirement System, but with the following modifications: (1) Offer cost-of-living adjustments at 70% of the annual change in the Consumer Price Index; (2) Raise the normal retirement age for full benefits to 60 while allowing retirements as young as 55, but with an actuarial reduction of 6-2/3% -- the same rate as Social Security -- for each year under 60.

For new employees hired after January 1, 1984, place them in a Social Security-based program like the one mentioned for current employees. For both groups offer a supplemental pension offering the following characteristics:

* Paid entirely -- except for Social Security and the thrift plan -- by the government;
* Costing no more than 8% of payroll for the supplemental pension -- a rate that, according to your consultants, Hay Associates, is comparable to amounts paid on average by the firms they survey each year;
* Incorporates actuarial reductions for early retirement;
* Provides no cost-of-living adjustments other than the annual increases offered by the Social Security component;
* Follows all ERISA requirements.

From a taxpayer perspective, we would prefer to see a defined contribution type plan ... simply because it is fully funded at all times and the government can precisely determine its costs.

If a defined benefit program is developed, we recommend a system that is fully integrated with Social Security. High income employees should receive greater replacement rates from the supplemental plan than those at the lower end to compensate for the tilt in Social Security benefits. From our point of view, all employees who retire at the same ages and with the same years of service should have the same replacement rates regardless of their salary levels.

As with a defined contribution plan, the total employer cost for the supplemental pension should not exceed 8% of payroll. This would mean a normal retirement age for full benefits of 65; retirements as young as 55 but with actuarial reductions of 4% per year under 65; cost-of-living adjustments equal to one-third of the annual change in the Consumer Price Index, with a cap of 5%.

Eligibility and Inflation Protection

You asked for our viewpoints concerning the adequacy and equity of individual benefits.

There are many misconceptions about the generosity of CSRS benefits. To clear away the smoke, we used two approaches for comparing benefits.

We took the actual pension formula for the CSRS and matched it against the benefits formula for Social Security and a typical Fortune 500 company pension. We took two employees who were identical in all respects except that one worked for the federal government and the other, for a Fortune 500 company. Both retired in 1974 with "high 3" salaries of $15,000. Both retired after 30 years of service. Note that we retired them in 1974 -- that allowed us to illustrate 10 years of actual cost-of-living experience.

Starting at age 55 in 1974, the federal retiree received $8,558; the private sector worker, just $2,700. Seven years later, at age 62 when the private sector retiree begins receiving Social Security, the federal retiree was up to $16,163; his private sector counterpart was receiving just $7,448. For the first ten years of retirement -- using actual cost-of-living adjustments -- the federal retiree received $131,043; the private sector retiree, just $42,446 ... less than one-third the amount. If these individuals live out their normal life expectancies and if we have 5% inflation for the remaining years, the federal retiree is projected to receive $402,702 in benefits during 21 years of retirement; the private sector counterpart, just $157,808.

Another way of comparing benefits is to look at individual components of the pension system ... at items like normal retirement ages and cost-of-living adjustments.

In the private sector, 65 is the normal retirement age for full benefits from Social Security. As you know, Social Security permits early retirement as young as 62, but only with a 20% penalty. And last year, Congress passed a provision that would raise the retirement age for full benefits to 67 by the year 2027 while increasing the penalty for early retirement at age 62 to 30%. The average Social Security retirement age is between 63 and 64.

There is a variety of data on retirement ages reported for private sector plans. According to the Bureau of Labor Statistics, the normal retirement age for corporate pension plans was 65 for 45% of the plans; 19% had ages between 61 and 64; only 10% had ages between 56 and 60.

As you know, a federal civilian employee can retire with full benefits at age 55 after 30 years of service. In 1982, 36% of all new retirees who took optional retirement went out under the 55/30 years of service provision. Since this committee brought up the question of equity in benefits, I am certain the American taxpayers would be interested in learning why federal employees should be permitted to retire at such young ages while those in the private sector must wait until age 65 to get similar full benefits.

The typical answer has been that the average retirement age for federal employees over the past 10 years has been 61.1 years while the average for private sector workers has been 61.5 years. That comparison, unfortunately, has been accepted at face value by many. Let's look a little closer at those statistics.

The 61.1 federal figure is a 10 year average for the period 1973 to 1982. The 61.5 year private figure is for 1978 only.

In addition, the 61.1 federal figure is for optional retirement only. It does not include disability or involuntary retirements, provisions that have significantly lower average retirement ages. However, that 61.5 private sector figure does, in fact, include disability retirement. Thus, we are comparing apples with oranges.

Let's look at how an objective, unbiased analysis would compare the data.

Looking at optional retirement only, the average for new federal retirees in 1978 -- the only year private sector data was available -- was 60.8. The average for the private sector normal retiree was 64.7 ... a 3.9 year difference, not the 0.4 year difference suggested by the misinterpreted data.

If you want to consider all types of retirement -- including disability -- and use the much quoted 61.5 figure for the private sector average retiree, the comparable federal average becomes 58.4 ... a 3.1 year difference.

Thus, proper interpretation of the data clearly shows that federal employees do, in fact, retire at ages significantly lower than their private sector counterparts.

For cost-of-living adjustments ... both the CSRS and Social Security provide COLAs equal to 100% of the change in the Consumer Price Index. But saying that the inflation adjustments are the same is like comparing a watermelon with a peanut.

That is because a 10% increase on $12,432 (average non-disability CSRS annual pension in 1981) is much larger than a 10% increase on $4,632, the average Social Security non-disability annual benefit in 1981. Even though both may receive the same 10% increase, the federal retiree takes home $780 more in hard dollars.

A study of corporate pensions by Hay Associates showed that in 1981 only 8% of the firms it surveyed had formal annual cost-of-living adjustments in their pension plans. However, of that 8%, all but one-half of one percent had annual caps of 4% or less.

Another study by the Bureau of Labor Statistics showed that only 3% of the plans it surveyed had COLAs in their normal pension formulas.

Other studies have shown that most private plans offer irregular or ad-hoc adjustments to provide some relief from inflation. When averaged over the long-term, these periodic adjustments amount to 1/3 the annual change in the Consumer Price Index. When all of this is combined with Social Security, the total effect is an annual private sector adjustment equal to about 70% of the change in the Consumer Price Index.

When we ran that 1/3 CPI assumption through our computer model for the age 55 retirees, we found that the private sector 21 year total increased from $157,808 to $176,302 ... still considerably lower than the $402,702 total for the federal retiree.

Financing

The final area you asked for our comments was in financing. You noted that the current funding is less stringent than imposed on private systems by federal law. You are right ... ERISA would not permit a half-trillion unfunded liability like you have today for the CSRS.

However, you suggested that the funding is more advanced than Social Security. Perhaps that is so, but Social Security is not shored up by general revenue appropriations. Social Security is limited by the total amount of money available in the Social Security trust funds; Civil Service has free access to the pocketbooks of every man and woman working in America.

Let's talk about unfunded liabilities.

No pension plan in America, other than the federal plans, has access to general revenues. The CSRS does. In fact, 87% of the money flowing into the system comes from the American taxpayers ... better than 50% of whom are not vested in any pension plan whatsoever. Take away that general revenue appropriation, and the current Civil Service fund dries up in less than five years. Is that financial soundness?

You ask about financial aspects of the system? ... let's look further.

During the 22 year period from 1960 to 1982, while outlays for Civil Service benefits rose 2101%, the number of federal retirees increased only 273%. Who paid for this significant increase in benefits? The answer is clear ... while taxpayer contributions rose 2667%, federal employee contributions increased only 449%.

The trends become even more disconcerting when compared to other economic factors.

Many say that the 1288% increase in Social Security outlays precipitated the system's recent fiscal crisis. But 1288% is nothing when compared to the 2101% increase for Civil Service. Everybody is talking about out-of-control federal spending and deficits. But during that 22 year period federal budget outlays increased only 690%, a rate far faster than the 504% jump in Gross National Product. Some federal employee groups point to inflation as the cause. But during that 22 year period, inflation rose only 225%.

So, when you hear that the Civil Service Retirement System is financially sound and solvent, keep the taxpayer perspective in mind and think about those strict funding requirements you impose on the rest of America.

How can the CSRS be brought up to acceptable funding levels? Very simply. Amortize the unfunded liability of the current system over an extended period, say 40 years. Use dynamic assumptions in calculating the unfunded liabilities. Reduce all benefits so that the normal cost for the government, as employer, is about 14% to 16% of payroll. Use a defined contribution approach for the new systems so that the plan is fully funded at all times. Finally, include all federal employees -- except those nearing retirement -- in the restructured system.

In closing, I would like to go back to the issue of whether a restructuring of the current system represents a breach of contract with the federal employees.

According to the U.S. Supreme Court, it does not.

So the ball is in your court.

We would suggest that Members of Congress have a more sacred contract with the American taxpayers who voted them into office to assure the responsible stewardship of their tax resources. We would also suggest that you have a sacred contract with the majority of federal employees who will never receive Civil Service retirement benefits. Their well-being should not be sacrificed so as to give extravagent benefits to the few.

We encourage you to develop a supplemental pension for new federal employees and to modify the current CSRS as we have suggested. Make certain that you receive an honest comparison to private sector benefits, one that compares apples to apples. We encourage you to use us as a resource in your further deliberations.

Thank you.